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By Fax (303-231-3194); Original by Mail
David S. Guzy
Chief, Rules and Procedures Staff
Royalty Management Program
PO Box 25165, MS 3101
Denver, Colorado 80225-0165

Re: Delegation of Royalty Management Functions to States, 62 Fed. Reg. 19967 (April 24, 1997)

Dear Mr. Guzy:

These comments are submitted on behalf of the California State Controller's Office (SCO) on the proposal of the Minerals Management Service (MMS) for Delegation of Royalty Management Functions to States. 62 Fed. Reg. 19967 (April 24, 1997).

Through this rulemaking, MMS proposes to transform what heretofore had been a mature, cooperative means of extending delegations to States into a bureaucratic maze of federal micromanagement. The requirements MMS proposes to impose on States range from the simply silly to the flatly unreasonable. And, in doing so, MMS opens the door to challenge over the means employed to account for, calculate and collect royalties. Even a quick review of MMS' proposal would lead one to suspect that the underlying purpose of this proposal is to reduce the role of the States in the royalty management program.

On top of this, MMS has set an extremely short comment period in which States must present objection to nearly 20 pages of a densely written proposal. While MMS states that this is necessary to meet a congressional deadline, given that the existing rules could have easily been amended to conform to the expanded authorities of the Federal Oil and Gas Royalty Simplification and Fairness Act, this rush can only be viewed as a product of MMS' desire to put in place roadblocks to delegating those expanded authorities to States. Indeed, despite the level of detail

contained in these regulations, MMS notes that it has not completed work on the "standards" that States will also have to meet under a delegation.

In order to meet MMS' short timeframe, SCO cannot detail in full all of its objections to the MMS proposal. Rather, SCO outlines below examples of some of the objectionable features of the proposed rule as a means of demonstrating the need for MMS to fully reexamine it. SCO also agrees with the comments submitted by the State of Montana.

1) Preamble. In the preamble, MMS states that it will continue to assume control over the administrative dispute resolution or settlement process and continue to involve the States as it has in the past. 62 Fed. Reg. at 19969. Under the Federal Oil and Gas Royalty Simplification and Fairness Act (RSFA), however, Congress has specifically required that the "Secretary and the State concerned" may take action to settle a claim. 30 U.S.C. §1724(i). "State concerned" is a broader category than delegated State under RFSA. Compare 30 U.S.C. §1702(22) with, §1702(31).

SCO objects to MMS' suggestion that the status quo will meet the provisions of the law. Currently, States are permitted to "participate" in the MMS settlement process only to provide technical support and all States "concerned" with a particular settlement are not necessarily invited to attend settlement meetings. The States' concurrence in a settlement is not presently required nor has MMS ever sought the affirmative concurrence of any State. The plain language of RSFA requires more than a continuance of the status quo; it requires States to be concurring parties to a settlement. Thus, MMS' preamble language does not comport with the legal requirements imposed upon it by Congress with regard to the conduct of settlements.

SCO has a particular concern with MMS' preamble language because of its belief that MMS intends to rely on settlements even more than it currently does to resolve royalty disputes. SCO recognizes that MMS in the recent past has felt a need to enter into settlements as a means of closing out older issues and moving its audit program forward. SCO however disagrees with the idea that settlements should become a regularly used, let alone preferred, tool in the MMS royalty management program. Settlements simply do not provide the type of guidance or closure needed to move the royalty program into the future. Rather, they invite continuous appeal over the same issues in the hope that the federal government will accept less.

2) In §227.103, MMS sets out the "minimum" information that a proposal "must" contain to obtain a delegation. While meeting these requirements will not be problematic for SCO, SCO believes that, taken together, MMS's proposals inappropriately interfere with State law matters, without a word of reasoned justification.

As a Constitutional Office of the State of California, SCO has legitimate concerns about unnecessary and unjustified federal intrusion into essential State functions and issues of State law. In this regard, SCO notes the following problems with this section.

- MMS apparently will require that one State agency be named that has the authority to perform all delegated functions. This is the plain meaning of proposed §227.103(c)(1). In some States, responsibility over the type of functions to be delegated may be split between different agencies. In others, two agencies may have equal authority under State law to assume the functions. SCO does not believe it was Congress' intention to force States to reorganize their agencies or to enact mini-RSFA's before becoming eligible for a delegation.

- MMS' requirement that a State prove its authority to perform "delegated functions," coupled with its lengthy and detailed list of those functions elsewhere in its proposed rule, suggests that it will deny a delegation unless the State produces a State law that extends it specific authority to, for example, process production reports. The likelihood that any State has a State law specifically authorizing that particular means of administering a program is not great, nor should it be required. Some States may extend general authority to agencies or some State entities may have constitutional authority over certain matters.[1]

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[1] We understand that MMS' proposal stems from its reading of Pueblo of Santa Ana v. Kelly, 104 F.3d 1546 (10th Cir. 1997). With all respect, we believe that MMS' reliance on this case is faulty. Kelly involved a "compact" between a State and Tribe, which, as Interior is surely aware, is a unique species of "contract" -- more in the nature of a treaty -- between sovereign entities. It involved a federal law that adopted state law as the governing substantive standard for the terms of the "compact." This is a far cry from a statute that authorizes delegations of authority to States to perform federal ministerial functions. But even assuming the relevance of Kelly, nothing in it even suggests that the authority must be spelled out in the level of "mini-RSFA" detail that is implied by MMS' proposal. See e.g., Willis v. Fordice, 850 F. Supp. 523, 532 (S.C. Miss. 1994)(law extending to governor generalized authority to transact state business authorized entering into IGRA compact). If MMS is going to adopt State law under its regulations, it must accept the State law determination with regard to the means by which that authority is extended. And, with particular regard to SCO, it must respect that the State Controller is not simply a State agency but a Constitutional Office with supervisory authority over all the fiscal affairs of the State, including the collection, receipt, accounting, auditing and

- MMS' requirement that a State have authority to receive State or Federal appropriations is confusing. It suggests that there must be a line item appropriation from a State specifically for funding delegated activities. States may receive general funds which may be expended under budget authorities. It also suggests that there must be funding from State derived as opposed to federally derived revenues.

- If MMS' proposal is directed at a concern that delegation contracts not be subject to challenge, SCO is certainly not unsympathetic. However, SCO would note that it knows of no instance in the over ten year period of the MMS program where a State delegation under FOGRMA was challenged. And, given the detail of MMS' proposal, challenge is more likely not less. Indeed, as a result of MMS' detailed proposal, nothing short of State enactment of a mini-RSFA would absolutely immunize a delegation from potential, if unlikely, challenge.

  SCO notes that while RSFA does require a State to "agree" to enact laws and promulgate regulations "where necessary" for it to have authority (30 U.S.C. §1735(b)(6)), nothing in that section or the legislative history can be read to require the States to enact the specific mini-RSFAs that would be required under the MMS proposal. Congress intended to provide the opportunity for States to expand their delegated activities and proceeded with the understanding that many States had already been extended delegated authority under FOGRMA. Congress never questioned MMS' current delegation program or the performance of the States thereunder. Given this backdrop, §1735(b)(6) can only be read to require a State to "agree" to enact legislation under circumstances where extant State law is inconsistent with a "relevant Federal" law (e.g., a law precluding collection of information from non-State owned lands) or would require State action demonstrably at odds with the federal activity.

  SCO also would note that an Attorney General opinion or other document, including a State law, would not immunize a delegation from all likelihood of challenge. MMS should extend deference to the State agency's own interpretation of its authority, just as the Secretary under the federal system is entitled to deference to his determinations of authority. Nothing in RSFA delegated to the Secretary the authority to make determinations as

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disbursement of federal monies.

to State law or to dictate how such determinations should be made under State law.

- Many of the "musts" under §227.103 border on the silly. For example, in an age where communication is increasingly done by computer, fax and other rapid means, it is highly questionable why the federal government would be concerned about the office location chosen by the State. Will North Dakota's delegation be in jeopardy because there are no direct flights to Bismarck? Is a delegation to California questionable because inconvenient for Houston-based Texaco? Can Alaska forget about a delegation because time zone differences make it inconvenient for federal officials in D.C. to reach it by phone? Similarly, of what concern is it to the federal government how much office space is available or how its office space is currently being used?

- SCO is concerned about the requirement that it "prove" the qualifications of the employees it assigns to perform delegated activities. The organization of the office and assignment of personnel is a matter specifically delegated to the Controller under State law. Cal. Gov. Code §12402. In addition, personnel must be assigned under stringent classifications set under State civil service laws. Cal. Gov. Code §18500 et seq. Under these authorities, SCO's current team for performing delegated activities meet and, in fact, exceed federal criteria. Finally, state privacy laws protect state employees and confidentiality restrictions are imposed on public release of employee information. See e.g., Cal. Gov. Code §18934. If the State has assigned personnel that it finds are qualified to perform the delegated functions, what right has the federal government to question that determination? If an employee named in a proposal leaves State employment during the term of a delegation, will the State's delegation be in jeopardy unless the federal government approves its personnel decisions? What of the privacy rights of State employees whose credentials may become fodder for debate during the public hearing? Is a State delegation in jeopardy because the MMS disagrees with "how" the State "propose[s] to hire ... persons" to perform delegated functions, a process, which at least in California is heavily regulated by State law?[2]

- The implication of these requirements is that if the

[2] By way of analogy, SCO doubts that MMS would welcome a public debate regarding the convenience of Lakewood, Colorado; the qualifications and credentials of its personnel; or its promotion and hiring practices.

> State's proposal does not meet some subjective measure of convenience or some unstated federal standard of personnel qualification, a delegation agreement can be denied. This essentially puts the federal government in control over the most basic and core organizational and operational functions of a State agency. Congress' intention under FOGRMA and RSFA was not to put the federal government in the position of dictating essential state functions, but to permit delegation to the states of federal functions. A delegation of authority implies a certain amount of freedom of action, and, at the very least assumes that the States should be free to determine their own staffing and operational needs.
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> The extent of interference into the essential administrative functions and decisions of a State agency set out and suggested by MMS' proposed §227.103 is simple federal overreaching. And, it is unnecessary given that the federal interest in performance will be met through MMS monitoring.

3) MMS' proposed §227.112 deals with compensation. SCO has concerns about the preamble explanation of this section. 62 Fed. Reg. at 19972. In other parts of its regulations MMS construes "delegated functions" very narrowly. For example, it lists as a required audit "function" the issuance of engagement letters. This suggests that MMS is going to compare on a micro level the cost of a State to issue an engagement letter and the cost of MMS to issue an engagement letter. MMS' preamble language supports such a narrow interpretation. This is both inefficient and silly.

SCO foresees that such an interpretation will have larger impacts down the road. For example, MMS audits only 2% of its universe. Will this mean that a State will be compensated for auditing only 2% of its universe?[3] MMS' universe of leases is much larger than those audited by any State and thus 2% represents a larger number of leases. In short 2% of a State's smaller universe may not be statistically significant enough to assure audit reliability. Moreover setting compensation at a percentage of lease coverage adversely impacts the independent judgment of the auditor, who depending on the circumstances, may believe a given problem requires more widespread review. Such a requirement would violate a panoply of government audit standards.

Congress provided that "Compensation to a State may not exceed the Secretary's reasonably anticipated expenditure for performance

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[3] During a recent meeting of the Eastern State and Western State Land Commissioners Associations, an MMS official indicated that under the MMS proposed rule a State's compensation would indeed be limited in the manner described above.

of such delegated activities by the Secretary." At least in terms of the audits, SCO believes that this must be read in terms of the Secretary's current practice for funding delegated State audits, under which the States' proposed funding becomes the benchmark for determining the "reasonably anticipated expenditure." There is no suggestion that Congress intended under RSFA to reduce the amount or method for determining State funding of delegated audits. Indeed, the legislative history demonstrates that Congress intended that "funding shall be consistent with current delegation of authority agreements." 1996 U.S.Code Cong. & Admin. News 1442, 1447.

4) Under proposed §227.200, MMS states that if a State needs guidance on the interpretation of a rule, it must submit a written request for such guidance and it must follow the interpretation or guidance given. SCO objects to this provision because it does not recognize that States have a right to appeal from valuation decisions. Moreover, States should be permitted to exercise their professional judgment on the application of MMS regulations as the facts uncovered through their activities warrant.

5) Under §227.300, MMS specifies the functions a State must perform in an audit. Generally, throughout this regulation, SCO believes that MMS has specified functions in an unnecessarily detailed manner. While SCO does not disagree that auditors should send out engagement letters, and as a matter of practice would always do so, it also believes that the audit process should not be inflexible. For example, some States might believe after initial review of a company's reports and other available information that a site visit is unnecessary because the level of risk is not great. The rationale for requiring such a site visit, when in the judgment of the auditor it is not necessary, simply invites resource waste.

If this level of specificity is to remain in the regulations, rather than being put (more appropriately) in standards, SCO also recommends that §227.300(h) be reworded to read "Issuing records releases and audit closure documents, as necessary." SCO's practice has been to issue audit reports, which it believes is a better practice. The letters MMS refers to are simply a duplicative waste of resources.

6) Under §227.301, MMS would require that a State agree to undertake special audit initiatives that MMS identifies. To the extent that this implies that the State would have to undertake such initiatives under the compensation provided for performing audits under its audit work plan, SCO objects. If this provision is to be retained, it should specifically provide that further funding will be granted for performing the tasks under a special initiative. Indeed, RSFA requires MMS to compensate a State for such activity at the level of the "reasonably anticipated expenditures." Since an initiative is by definition something over and above a regular audit program, a State must be compensated for

it if MMS is going to require state participation.

7) Under §227.301, MMS specifically references and binds a State to MMS' Annual Audit Work Plan and 5-year Audit Strategy. SCO believes that reference in a rule (that can be changed only through notice and comment) to a specific "strategy" or work plan is unwise. MMS revises its strategies periodically and given the new deadlines under RFSA, it is not unlikely that its strategy might need to be changed. Moreover, SCO strongly believes that delegated States should be permitted to design their own strategies which in their professional judgment are necessary to assure coverage and to meet time frames. SCO, as MMS is aware, has consistently advocated that audits should be completed in a three year cycle and through that approach, unlike MMS, SCO has consistently kept its federal audit program current. The new deadlines under RSFA simply buttress the advisability of such an approach.

MMS, here and elsewhere, is using RSFA and this rulemaking as a means to impose on the States requirements that have not been previously imposed on delegated audits. There is nothing in RSFA or its legislative history that suggests that Congress intended such absolute mimicry by the States of the MMS program.

8) Under §227.400 MMS states that those assuming the authority to process production reports may perform the optional function of granting exceptions from reporting and payment requirements and approving alternative royalty and payment requirements. SCO notes that under RSFA, "the State concerned" must concur in the grant of such relief even if it is proposed by MMS alone. 30 U.S.C. §1726(c). As noted previously, under RSFA the language "State concerned" covers a broader category of States than the term "delegated State". To the extent that MMS implies in this regulation that only a State assuming authority to process production reports may play a role in determining whether relief is warranted, SCO objects on the grounds that the proposal is contrary to law.

9) Under §227.600, MMS would require a State that assumes authority to do automated verification to check "unit prices for reasonable product valuation based on reference price ranges MMS provides." To SCO's knowledge, MMS does not perform that function and to the extent that it has attempted such verification, its attempts have been unsuccessful. MMS cannot impose on a State a requirement that it cannot meet itself or that it does not perform.

As noted above, these comments address only examples of SCO's objections to this proposed regulation. SCO has found nothing in RFSA that would require MMS to promulgate regulations with such inflexible detail. While a certain degree of uniformity is both required and desirable, States that want to assume delegated authority should be permitted some flexibility to do things a

better way and to exercise professional judgment. A cooperative endeavor between the States and MMS that permits a degree of flexibility and experimentation by all participants can only serve to enhance the royalty management program. MMS appears to assume that its system is not broken and is the best available and that thus it should be imposed on the States in full measure. Unfortunately, time and again, this has been proved untrue. Both the MMS and the States should remain open to change. Neither should be bound by nor have their activities challenged for not following the letter of these overinclusive rules.

Sincerely,

Lee Ellen Helfrich